No. 10233

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

THOR W. HENRICKSEN, Acting Collector of Internal Revenue,

Appellant

vs.

W. BRAICKS and J. G. MOLZ, Liquidating Trustees of Pommerelle Company, Inc., a Corporation,

Appellees

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE LEWIS B. SCHWELLENBACH, *Judge*

BRIEF FOR THE APPELLANT

SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
A. F. PRESCOTT,
PAUL R. RUSSELL,
Special Assistants to the Attorney General.

J. CHARLES DENNIS,
United States Attorney.
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OPINION BELOW

The opinion of the District Court (R. 15-34) is reported in 43 F. Supp. 254.

JURISDICTION

This is an appeal from a judgment entered March 4, 1942, and amended May 8, 1942, by the Dis-

trict Court in favor of the appellees, liquidating trustees of the Pommerelle Company, Inc., for $8,338.98 with interest. (R. 43-46.) Appellees' complaint sought recovery from the appellant, the Acting Collector of Internal Revenue, of corporation income and excess-profits taxes and interest for 1937 assessed against and paid to him by Pommerelle Company, Inc., in the sum of $8,338.98, together with interest from the date of payment. (R. 2-7.) The action arose under the Internal Revenue laws of the United States (Sections 23 and 27 of the Revenue Act of 1936), jurisdiction having been vested in the United States District Court under Section 24, Fifth, Judicial Code. The case is brought to this Court by notice of appeal filed June 1, 1942. (R. 46-47.) The jurisdiction of this Court is invoked by virtue of the provisions of Section 128(a) of the Judicial Code, as amended.

QUESTION PRESENTED

In 1937 the stockholders of the taxpayer corporation appointed appellees as liquidating trustees to liquidate the company and wind up its affairs. This action was taken upon the advice of tax counsel for the sole purpose of effecting a reduction in the company's excess-profits taxes through the organization of a new corporation. Although the corporate debts

were not paid, and no formal instruments were executed assigning and conveying the assets to the stockholders, the trustees prepared a statement listing the *pro rata* share of each stockholder in the capital and surplus shown on the books and advised the stockholders to report as income in their respective income tax returns the respective amounts of the liquidating dividend to which they would have been entitled based upon such statement. Thereupon the liquidating trustees assigned the assets (subject to the liabilities) directly to a new corporation, organized for the purpose of carrying on the business, whose stock was issued ratably to the stockholders of the old company in exchange. Under Section 27(f) of the Revenue Act of 1936, is the taxpayer entitled to a dividends paid credit for the purported liquidating dividend to its stockholders?

STATUTES INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 14.—SURTAX ON UNDISTRIBUTED PROFITS.

(a) *Definitions.*—As used in this title—

(1) The term "adjusted net income" means

the net income minus the sum of—

(A) The normal tax imposed by section 13.

* * *

(c) *Adjusted Net Income Less Than $50,000.*—

(1) Specific credit.—If the adjusted net income is less than $50,000, there shall be allowed a specific credit equal to the portion of the undistributed net income which is in excess of 10 per centum of the adjusted net income and not in excess of $5,000, such credit to be applied as provided in paragraph (2).

(2) Application of specific credit.—If the corporation is entitled to a specific credit, the tax shall be equal to the sum of the following:

(A) A tax computed under subsection (b) upon the amount of the undistributed net income reduced by the amount of the specific credit, plus

(B) 7 per centum of the amount of the specific credit.

* * *

SEC. 27.—CORPORATION CREDIT FOR DIVIDENDS PAID.

(a) *Dividends Paid Credit in General.*—For the purposes of this title, the dividends paid credit shall be the amount of dividends paid during the taxable year.

* * *

(f) *Distributions in Liquidation.* — In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes

of computing the dividends paid credit under this section, be treated as a taxable dividend paid.

* * *

(h) *Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

Remington's Revised Statutes of Washington, Vol. 5, 1940 Annual Pocket Part:

Sec. 3803-52. *Trustees—Powers and Duties.*

1. The trustee or trustees appointed by the shareholders to conduct a winding up out of court shall, as speedily as possible after his or their appointment has become operative as provided in section 3803-49, proceed.

a. to collect all sums due or owing to the corporation;

b. to sell and convert into cash any and all corporate assets;

c. to collect the whole, or so much as may be necessary or just, of any amounts remaining unpaid on subscriptions to shares, and

d. out of the sums so realized, to pay all debts and liabilities of the corporation according to their respective priorities.

2. Any surplus remaining after paying off all debts and liabilities of the corporation shall be paid by the trustee or trustees to the shareholders according to their respective rights and preferences.

3. Nothing in this section shall interfere with a reorganization pursuant to provisions hereinafter contained in this act.

Sec. 3803-56. *Commencement of dissolution proceedings — Effect.*

1. A proceeding for dissolution shall be deemed to commence

a. at the time of the passage of the resolution therefor, if the proceeding is out of court;

* * *

2. When a proceeding for dissolution has commenced,

a. the authority and duties of the directors and officers of the corporation shall cease, except in so far as may be necessary to preserve the corporate assets, or in so far as they may be continued by the trustee or receiver, or as may be necessary for the calling of meetings of shareholders;

* * *

STATEMENT

W. Braicks and J. G. Molz, appellees herein, instituted this suit as liquidating trustees of the Pommerelle Company, Inc., a corporation organized in 1934 (R. 35, 112) and having its principal place of business in the State of Washington, for the recovery of $8,338.98, corporation income and excess-profits taxes and interest paid to the Collector of Internal Revenue, the appellant, with interest (R. 2-7, 35-36, 39-40). The controversy brought to this Court upon appeal relates to a dividends paid credit claimed by the taxpayer for 1937 by reason of the alleged distribution of $61,423.39 to its stockholders. (R. 39, 82.) The Commissioner of Internal Revenue concluded that the steps taken amounted to a reorganization of the taxpayer, that in fact no taxable dividend had been paid to the stockholders, and that the corporation was

not entitled to a dividends paid credit by reason of the purported distribution. (R. 75-79.) The income and excess-profits tax liability for 1937 having been assessed and paid upon the basis of the Commissioner's determination, a claim for refund was filed on April 9, 1940, alleging that the Commissioner's action was erroneous in respect of the credit disallowed. (R. 8-12, 39-40.) The Commissioner having failed to allow the claim, the instant suit was begun on October 22, 1940. (R. 2-12, 40.)

The facts relevant to the controversy may be briefly stated. In September, 1937, the directors of the Pommerelle Company, Inc., concluded that the stated value of the company's capital stock was too low with the result that the corporation was paying excess-profits taxes in an amount larger than the company's situation required. (R. 37.) For the sole purpose of attempting to correct this situation and on the advice of tax counsel, proceedings were instituted for the liquidation of the corporation and a resolution was passed duly appointing the appellees herein as trustees to wind up and liquidate the assets and affairs of the company and to conduct a voluntary liquidation and dissolution out of court in accordance with the laws of the State of Washington. (R. 37.)

According to the minutes introduced in evidence the new corporation "The Pommerelle Company" was organized about September 25, 1937, by the stockholders of the old company. (R. 38, 94-97.) The new corporation was organized prior to dissolution of the old to prevent any hiatus in the corporate existence which might affect the company's wine and blender's basic permit or its standing with the Federal Alcohol Tax Unit. (R. 109-110, 115-116, 145.) The minutes indicate that on September 28, 1937, the stockholders of the old company subscribed to the stock of the new corporation in amounts equal to their respective shares in the net worth of the old company as reflected in its balance sheet of October 4, 1937. [1] (R. 38, 100-101, 104.) On September 30, 1937, the minutes record the authorization for the liquidation of the old company and the appointment of appellees as liquidating trustees with power to execute all papers and documents required in connection with the company's dissolution. (R. 88-89.)

At a special meeting of the stockholders of the old company held on October 4, 1937, the appellees re-

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[1] Some of the stockholders did not sign the subscription list on which their names appeared, their signatures having been affixed by others. (R. 161-162.)

ported "that they had liquidated the assets and affairs of the company by distributing the same to stockholders of record in undivided portions in the amounts set opposite their names." (R. 89-90.) The amounts listed opposite the names of the stockholders aggregated $61,423.39, which was the net worth of the corporation on October 4, 1937, as reflected in its books of account. (R. 90, 102-104.) The stockholders present thereupon voted to approve the report of the trustees and to accept their proportionate shares of the assets of the company. (R. 90.) No bill of sale, deed or other instrument was executed to effect the transfer of the corporate assets to the individual stockholders. (R. 115, 119.)

On the same day that the liquidating trustees reported they had distributed the "assets and affairs" of the taxpayer corporation to the stockholders, the new company voted to accept an offer to take over the assets of the old company and to assume its liabilities in payment of subscriptions to its stock. (R. 90, 106.) The offer referred to, as set forth in the minutes of October 4, 1937, was dated September 30, 1937, and purported to enclose a balance sheet dated October 4, 1937. (R. 101-104.) The subscribers were the stockholders of the original corporation whose proportionate interests in the enterprise were continued in the

new corporation without change. (R. 101-102, 118.) The liquidating trustees then executed formal instruments to effect the transfer of the assets to the successor corporation which issued its stock therefor. (R. 38-39.) There was some discussion of the possibility of paying off in cash any stockholder who might not wish to continue with the enterprise, but no one withdrew. (R. 143-144.) The assets and liabilities were then entered upon the books of the new corporation exactly as they had theretofore been carried on the books of the predecessor. (R. 118.) A contract for the purchase of real estate was overlooked at the time and an instrument to effect the transfer of this interest in real estate was not executed until a later date. (R. 114-115, 119, 146-147.)

The court below held that as the result of the foregoing steps " * * * the assets of the corporation were transferred to and vested in the plaintiffs (appellees) as trustees for the stockholders and as liquidating trustees for the company." (R. 37.) Commenting that any stockholders who did not wish to continue with the new company could have disposed of his proportionate share in the assets held by the trustees, [2] the trial court concluded that the transfer by appellees of the assets to the new corporation was made by them as trustees for the individual stock-

holders and not as liquidating trustees of the old company. (R. 41.) With respect to the Commissioner's conclusion that the steps amounted merely to a reorganization of the taxpayer corporation, the District Court held that the continuity of interest requisite to a statutory reorganization did not exist. (R. 41.)

With reference to the amount of the dividends paid credit, the sum claimed in the taxpayer's return for 1937 was $61,423.39; however, the evidence shows that the accumulated earnings and profits available for distribution at the date of the alleged dividend amounted to only $35,923.39. (R. 81-82.) Apparently, the remainder of the distribution of $61,423.39 represented capital invested in the enterprise. (R. 129.) All but one of the stockholders paid individual taxes upon their shares of the liquidating dividend. (R. 38.) Claims for refund have been filed on behalf of some of the stockholders

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(2) The evidence to support this observation was to the effect that financial arrangements were made so that any stockholder who might wish to do so could sell his interest (R. 132, 151, 163), but no price was fixed in case anyone should have wanted to sell (R. 180), some of the stockholders did not know to whom to sell should they want to withdraw (R. 157-158, 193), and all understood that the assets of the old company were to be transferred to the new company (R. 167).

to protect their interests in case it is held no taxable distribution was effected. (R. 136.)

An issue with respect to the deductibility of certain expenditures which was decided adversely to the Collector by the court below need not be discussed here since the appeal relates solely to the issue relative to the dividends paid credit.

STATEMENT OF POINTS TO BE URGED

The District Court erred in entering judgment for the appellees and against the appellant for $8,338.98 and interest; conversely, the court erred in failing and refusing to enter judgment for the appellant dismissing appellees' suit, with costs.

The District Court erred in finding and concluding that the Pommerelle Company, Inc., distributed its assets to its stockholders on October 4, 1937. Conversely, the court erred in failing to hold that the assets of the Pommerelle Company, Inc., were transferred and conveyed by it directly to the newly organized Pommerelle Company.

The District Court erred in failing and refusing to hold that the Pommerelle Company, Inc., was not entitled to a dividends paid credit for 1937 within the

meaning of Section 27 of the Revenue Act of 1936 in that the transaction in controversy constituted a non-taxable reorganization and not a liquidation of the Pommerelle Company, Inc.

SUMMARY OF ARGUMENT

The assets of the Pommerelle Company, Inc., were transferred directly to the new Pommerelle Company; they were not distributed to the stockholders of the original corporation as a liquidating dividend. The steps taken, including the authorization of the distribution in liquidation of the properties and assets of the predecessor corporation to its stockholders, the preparation of a list showing the *pro-rata* shares of the stockholders in the dividend authorized and the reporting of the dividends by the majority of the stockholders as income in their respective income tax returns were insufficient to effect the distribution contemplated. Therefore, the Commissioner's disallowance of the dividends paid credit claimed in respect of the alleged dividend was proper.

Moreover, apart from the failure of appellees to comply with formal requirements for transferring interests in real and personal property, looking to the substance of the matter, no distribution to the stock-

holders was effected. Viewing the transaction as a whole it is plain that the parties in control merely reorganized the company upon the advice of their accountant, believing a saving in the annual excess-profits taxes could thus be effected. We submit further that if a wholly unnecessary step had been taken in connection with the reorganization such as the purported distribution of the properties and assets to the stockholders immediately preceding the transfer thereof to the new company by the liquidating trustees, this should not lead to a tax result differing from that which would have followed had the reorganization been effected by the natural and simple procedure of a transfer direct from the original company to its successor.

ARGUMENT

I.

THE ASSETS OF THE TAXPAYER CORPORATION WERE TRANSFERRED DIRECTLY TO ITS SUCCESSOR BY THE LIQUIDATING TRUSTEES; THEY WERE NOT DISTRIBUTED TO THE STOCKHOLDERS AS LIQUIDATING DIVIDENDS

Under Section 3803-52, Remington's Revised Statutes of Washington, Vol. 5, 1940 Annual Pocket

Part, *supra*, proceedings for dissolution commence upon the adoption of a resolution providing for the liquidation of a corporation. Plainly the adoption of such resolution does not in itself accomplish the dissolution and liquidation of the company. The statute provides that the trustees in liquidation shall proceed to convert the corporate property into cash and to pay off all debts and liabilities, except in case of reorganizations. Attention is invited particularly to the exception.

We find nothing unique in Washington law insofar as the fiduciary relationship between liquidating trustees and the corporation in process of dissolution is concerned. Accordingly, we think that the appellees herein were acting for the Pommerelle Company, Inc., pursuant to their appointment as liquidating trustees when they assigned its assets to the new Pommerelle Company in October, 1937. The decision of the court below was predicated upon its conclusion that their assignment of the assets to the new company was made by appellees acting for the individual stockholders. This, we think, was erroneous.

The record shows that, acting upon the advice of an accountant, those controlling the Pommerelle Company, Inc., contemplated the dissolution of the existing

corporation and the organization of a new company to take over its going and profitable business. Consistent with the advice of the accountant, it was planned to divide the reorganization into two separate steps. In the first place a liquidating dividend was to be declared. Secondly, the stockholders were to assign their dividends to the newly organized company in exchange for its stock. However, we think that this plan was not carried out, in that there was no liquidation of the assets, no payment of the debts, and no distribution of the net proceeds to the stockholders. On the contrary, the evidence shows in our oponion that the liquidating trustees assigned the assets directly to the new corporation, subject to the outstanding debts. Whether the literal consummation of the plan in two steps involving the formal payment of the dividend, followed immediately with the retransfer of the assets to the new company would have justified the court in holding that the taxpayer paid a dividend to its stockholders, thus entitling it to a dividends paid credit, is doubtful in our opinion but we shall discuss this point in the second part of our argument. We should like to present first our reasons for believing that there was in fact no liquidating distribution to the stockholders.

Perhaps the most glaring omission in carrying

through the first step of the plan lay in the failure of the liquidating trustees to execute any instrument to transfer and convey the original company's interests in property and other assets to the stockholders. Moreover, the debts were not liquidated and there was no written undertaking by the stockholders providing for their assumption of such debts. A contract for the purchase of real estate was completely overlooked until long afterward. In our opinion there was at most a mere intention to route the assets to the new corporation via the stockholders, and such intention was not translated into accomplished fact.

Although the court below seems to have recognized that no actual distribution was made to the individual stockholders, its opinion suggests that they had certain rights and might have insisted upon receiving their proportionate shares in the assets from the liquidating trustees. (R. 28.)

Accordingly, a closer scrutiny of the mechanics of the transaction seems necessary. If the minutes could be relied upon, there was a half-hour's interval between the time (10:00 a. m., October 4, 1937) the liquidating trustees of the Pommerelle Company, Inc., reported to the stockholders that they had distributed the assets to the stockholders in undivided portions

and the time (10:30 a. m., October 4, 1937) the new company voted to accept the offer of the assets subject to the liabilities in payment of stock subscriptions. (R. 89, 105.) However, that the minutes are unreliable is demonstrated by the fact that the letter offering the assets to the new company was dated September 30, but purported to include a balance sheet dated October 4! (R. 101-104.) Further evidence of the unreliability of the minutes is found in the circumstance that a list of the stockholders, who allegedly subscribed on September 28 to the stock of the new corporation, showed subscriptions to the new stock in amounts exactly sufficient (disregarding sums less than $1) to absorb the capital and surplus as reflected in the balance sheet of October 4. (R. 101-106.)

From the testimony of appellees' witnesses when questioned concerning their receipt of the alleged dividends, it is inferable that the dividends were to them purely a matter of bookkeeping. (R. 64, 146-148, 166-167, 180-181, 190-191.) In this connection we invite attention to the well settled rule that realities and not bookkeeping entries are controlling in the matter of determining income. *Southern Pac. R. Co. v. Muenter*, 260 Fed, 837 (C.C.A. 9th); *Doyle v. Mitchell Brothers Co.*, 247 U.S. 179. Since appellees admit that no bill of sale or other instrument was executed

to effect the assignment and conveyance of the assets to the stockholders (R. 115, 118-119), the conclusion of the trial court that the trustees were acting for the stockholders conflicts with the generally accepted rule that liquidating trustees of a corporation act on behalf of the company in dissolution.

Aside from the fact the times and dates of the purported steps taken to dissolve the taxpayer and to transfer its going business to a new corporation were obviously recorded in the minutes to suit the purpose of the parties instead of constituting a true chronological record of the events, as they occurred, we invite attention to the accepted principle that interrelated parts of a given transaction requiring a series of steps are to be treated as a whole, and immaterial differences in time disregarded. *Helvering v. Bashford*, 302 U.S. 454; *United Light & Power Co. v. Commissioner*, 105 F. (2d) 866 (C.C.A. 7th), certiorari denied, 308 U.S. 574; *Electrical Securities Corp. v. Commissioner*, 92 F. (2d) 593 (C.C.A. 2d). In this connection see also *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, where the Court disregarded an ostensible distribution to the stockholders in view of the fact the funds were not to be retained by the stockholders but were to be used to pay off corporate debts. In keeping with this principle, we think the apparent interval of a half hour

after the trustees informed the stockholders at 10:00 a. m., on October 4 that they had distributed the assets to them and prior to the time the new corporation accepted the offer to take the assets in payment for stock subscriptions should be ignored.

The trial court indicated that it was influenced by the fact that all but one of the stockholders affected paid income taxes upon the alleged liquidating dividends, treating them as income. (R. 28.) With due deference, we suggest that the court has fallen into error in predicating its decision on this circumstance. In our opinion it is necessary to distinguish between the facts and the self-serving action of the interested parties in reporting the receipt of the dividend which amounted only to a representation that they had received the amount of the distribution. For stockholders of a company to have paid a comparatively small sum individually in order that collectively they might avoid payment of a much larger amount of income and excess-profits taxes may have seemed good business. It was good business also to reorganize the company to accomplish a saving in excess-profits taxes, we have no doubt, and the Government has not challenged the right of the new corporation to its saving in excess-profits taxes by virtue of the larger declared value of its capital stock. We do challenge, however, the

proposition that a corporation may entirely omit the distribution of its assets to its stockholders preliminary to the transfer thereof to a new corporation and still be entitled to a dividends paid credit as if the distribution had been effected.

That there was never any intention of liquidating and abandoning the lucrative business of the taxpayer corporations is clear, and that the principal purpose in organizing a new company was to obtain a higher declared value upon the capital stock is also clear. (R. 85-86, 112-116, 147, 157.) A simple amendment to the company's charter would have accomplished an increase in the number of shares of stock and would have had the effect of capitalizing earned surplus. However, the accountant upon whose advice the interested parties relied, after consulting certain tax services concerning the proceedings to be employed in accomplishing the end desired, concluded that a new company should be organized. (R. 123-125.) We do not criticize the judgment of the tax adviser nor of the interested parties as it is quite possible that the only method of obtaining the higher declared value and thus to reduce excess-profits taxes was to organize a new company. We do not believe, however, that any theoretical distribution to the stockholders should be recognized in view of the absence of any instru-

ment sufficient to convey and assign the assets and interests in property to them individually. Parenthetically it may be pointed out that there is no evidence the amounts listed as the shares of the stockholders in the distribution in liquidation represented the real value of their respective shares in the assets since the allocation was based upon book values. (R. 127-129.) Admittedly the company's operations were highly profitable at the time so that we think it probable the book values constituted no true measure of the actual fair market value of the stockholder's respective interests in the enterprise. The desire to obtain a higher declared value lends added support to this conclusion.

If it be assumed for purposes of argument that the State of Washington levied excise taxes upon transfers of properties, assets and interests in property such as those here involved, it is pertinent to inquire if it could be successfully maintained that two transfer taxes would have been incurred under the facts of record when it is clearly established that the liquidating trustees made but the one assignment and that directly to the new corporation. We think it obvious the original company could not have been held liable for a transfer tax when it voted to liquidate since the corporation in dissolution continued to be the legal owner of its assets and property interests. Thus

a recognition of two separate transfers would require the recognition of a transfer from the liquidating trustees acting on behalf of the original corporation to themselves acting as agents for the individual stockholders. To recognize such a shifting of ownership without the execution of a bill of sale or other instrument would seem to open the door to grave abuses such as those the statute of frauds was intended to remedy.

In closely analogous situations involving sales of corporate properties by trustees in dissolution, or by the stockholders, taxation of the gains to the corporation has been repeatedly upheld. *Steinberger v. United States*, 81 F. (2d) 1008 (C.C.A. 9th); *Taylor Oil & Gas Co. v. Commissioner*, 47 F. (2d) 108 (C.C.A. 5th); *Embry Realty Corp. v. Glenn*, 116 F. (2d) 682 (C.C.A. 6th). Cf. *Helvering v. General Utilities & Operating Co.*, 74 F. (2d) 972 (C.C.A. 4th), reversed, 296 U. S. 200. In our opinion, there is no sound basis for distinguishing the general rule applicable under the facts here from the rule applied by the courts in the above cases.

A case with some superficial similarity to this proceeding should perhaps be noted, *Commissioner v. Falcon Co.*, 127 F. (2d) 277 (C.C.A. 5th.) Attention is

invited, however, to an important difference in that before the sale of the oil leases there involved, the taxpayer corporation actually distributed its interests in the leases to its stockholders, who thereupon sold such interests to the buyer. The court held in the absence of fraud that the profits were not taxable to the corporation, and that the sale was that of the individual stockholders. It should be noted too, that the *Falcon* case did not involve a reorganization, and the court observed specifically that the record showed no subterfuge or use of mere form to hide the substance of the real transaction. Cf. *Chisholm v. Commissioner*, 79 F. (2d) 14 (C.C.A. 2d), certiorari denied, 296 U. S. 641.

Before taking up the subject of reorganization, the applicability of Rule 52(a), Federal Rules of Civil Procedure, relative to the effect of the trial court's findings of fact should perhaps be mentioned. The court below found that the assets were "transferred to and vested in the plaintiffs as trustees for the stockholders and as liquidating trustees of the company." (R. 37.) In our opinion, this finding is ambiguous and the court indicates its confusion by the failure to distinguish between the office of the trustees as liquidators of the corporation and their purported office as agents for the individual stockholders.

It is arguable that the finding amounts only to a legal conclusion. We think that insofar as the court's findings construe the transactions in controversy as effecting a distribution to the stockholders, it is at most a mixed question of law and fact and there are no evidentiary facts to justify the conclusion that the distribution was effected. It is well settled that an ultimate finding of a trial court, contrary to the evidentiary findings or based upon a misapplication of law to the evidentiary findings, is not binding upon the appellate court. *Katz Underwear Co. v. United States*, 127 F. (2d) 965 (C.C.A. 3d); *United States v. Armature Rewinding Co.*, 124 F. (2d) 589 (C.C.A. 8th); *Fleming v. Palmer*, 123 F. (2d) 749 (C.C.A. 1st); and *Himmel Bros. Co. v. Serrick Corp.*, 122 F. (2d) 740 (C.C.A. 7th). Cf. *Equitable Life Assur. Soc. v. Irelan*, 123 F. (2d) 462 (C.C.A. 9th), holding that Rule 52(a) was intended to accord with the decisions on the scope of review by the appellate courts in federal equity practice.

It may not be amiss to comment that the Government stands ready to refund to the individual stockholders any overpayments due them by reason of reporting the liquidating dividends as income, and we note in this connection that the appellees have filed

timely claims to protect their interests in order that such individual overpayments may be recovered.

II.

ASSUMING THAT THE ALLEGED DISTRIBUTION TO THE STOCKHOLDERS IN LIQUIDATION WAS EFFECTED IT SHOULD BE DISREGARDED AS AN EXTRANEOUS AND UNNECESSARY STEP IN A PLAN OF REORGANIZATION

Some of the discussion under Point I is relevant to our argument here, particularly that portion wherein it was urged that the purported distribution in liquidation should be ignored, even if the Court were persuaded such distribution was momentarily accomplished prior to the retransfer of the assets to the new company. We now wish to amplify this contention and to carry it to its logical conclusion, namely, that the steps taken were interrelated parts of a single indivisible plan of corporate reorganization, thus justifying the Commissioner's refusal to recognize the alleged distribution of the liquidating dividend.

We have heretofore pointed out that notwithstanding recitals in the corporate minute books, the steps taken to dissolve the taxpayer corporation and to organize its successor to continue the business were obviously carried out at approximately the same time

as interrelated parts of a single plan and not at different times as a series of separate and unrelated transactions. Moreover, the trial court has specifically found it to be a fact that the sole purpose of the directors was to correct the situation which had arisen by reason of the fact the corporation was paying excess-profits taxes in an amount larger than the company's situation required due to the declared value of the capital stock being too low. (R. 37.) The evidence clearly supports this finding as to the underlying purpose for the dissolution of the original company and for the organization of its successor. In all the testimony we find no hint of any intention or desire on the part of a single stockholder to liquidate and abandon the company's profitable business.

Under such circumstances we believe that substance and not form should control for purposes of taxation and that both from the standpoint of the new corporation and from the standpoint of the stockholders the transfer should be treated as one made directly from the taxpayer to its successor. To charge the stockholders with the receipt of income based upon bookkeeping entries or based upon a transitory shifting of the company's assets to them would seem to be a highly technical application of the taxing statutes. This reasoning is supported,

in our opinion, by the great weight of authority: *Gregory v. Helvering*, 293 U.S. 465; *Minnesota Tea Co. v. Commissioner*, 302 U.S. 609. Cf. *Higgins v. Smith*, 308 U.S. 473; *Griffiths v. Commissioner*, 308 U. S. 355; *Lucas v. Earl*, 281 U.S. 111.

The court below held that the continuity of interest requisite for the establishment of a reorganization did not exist. (R. 41.) We fail to see how a greater continuity of interest is possible since all stockholders continued in the new corporation without any change whatever in their proportionate holdings of capital stock.

CONCLUSION

The taxpayer's assets were never in fact distributed among the stockholders as a liquidating dividend. Moreover, even if such distribution had been accomplished, this would have constituted but one of a series of steps in a plan of reorganization under which it was contemplated that the assets and interests in property would be immediately passed on to the new corporation organized for the sole purpose of continuing the business. Under these circumstances the alleged distribution, being momentary and unnecessary as well, should be disregarded. Hence the dividends paid credit for the alleged distribution was

properly disallowed by the Commissioner. The decision below is erroneous. The case should be remanded with instructions to modify the judgment by eliminating therefrom that part of the recovery attributable to this issue.

Respectfully submitted,

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